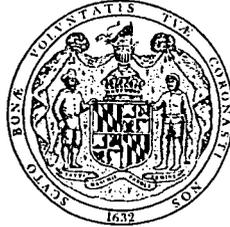


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TASK FORCE ON THE EXEMPTION OF  
LAW ENFORCEMENT OFFICERS' PENSIONS FROM TAXATION

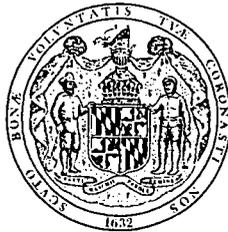
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JAN 27 2005

MARYLAND STATE ARCHIVES

# TASK FORCE ON THE EXEMPTION OF LAW ENFORCEMENT OFFICERS' PENSIONS FROM TAXATION

Senator David R. Brinkley  
Delegate Steven J. DeBoy, Sr.  
Senator James E. DeGrange, Sr.  
Major William M. Downing  
Howard Freedlander  
Dean Kenderdine



Jay Ladin  
Thomas K. Lee  
Delegate Robert A. McKee  
Captain Richard E. Norman  
Sergeant Cole B. Weston  
C. Vernon Wilhelm, Jr.

December 28, 2004

The Honorable Robert L. Ehrlich, Jr., Governor  
The Honorable Thomas V. Mike Miller, Jr., President of the Senate  
The Honorable Michael E. Busch, Speaker of the House

Gentlemen:

On behalf of the Task Force on the Exemption of Law Enforcement Officers' Pensions from Taxation, I am pleased to transmit to you the Task Force's final report.

The Task Force was established in the Fall of 2004 pursuant to Chapter 534 of the Laws of Maryland (2004). The Task Force was charged to study the issue of exempting members of the State Police Retirement System, the Law Enforcement Officers' Pension System, the Local Fire and Police System, any local law enforcement officers system, and State parole and probation officers from paying Maryland income taxes on their pensions. The Task Force report outlines six proposals/cost estimates for your future consideration.

I trust that the enclosed report will serve as a useful resource for further discussion and deliberation on this topic. My colleagues and I are grateful for the opportunity to serve on this Task Force.

Sincerely,

A handwritten signature in cursive script, appearing to read "Tom K Lee".

Thomas K. Lee  
Chairman

**TASK FORCE ON THE EXEMPTION OF LAW ENFORCEMENT OFFICERS'  
PENSIONS FROM TAXATION**

**ROSTER**

**David R. Brinkley, Senator**

**Steven J. DeBoy Sr., Delegate**

**James E. DeGrange, Senator**

**William M. Downing, Major, Law Enforcement Officers' Pension System**

**Howard Freedlander, Treasurer's designee**

**Dean Kenderdine, Comptroller's designee**

**Jay Ladin, Secretary of Budget & Management's designee**

**Thomas K. Lee, Executive Director State Retirement Agency (Chairman)**

**Robert A. McKee, Delegate**

**Richard E. Norman, Captain, State Police Retirement System**

**Cole B. Weston, Sergeant, Maryland State Fraternal Order of Police**

**C. Vernon Wilhelm, Jr., Baltimore City Retired Police Benevolent Association**

## INTRODUCTION

The Maryland General Assembly enacted HB1125, Chapter 534 of the Acts of 2004, which created the Task Force on the Exemption of Law Enforcement Officers' Pensions from Taxation. The Task force consisted of twelve members:

- two members of the Senate, appointed by the President of the Senate
- two members of the House of Delegates, appointed by the Speaker
- the Secretary of Budget and Management, or his designee
- the State Treasurer, or her designee
- the Comptroller of Maryland, or his designee
- the Executive Director of the State Retirement Agency, or his designee
- four Gubernatorial appointments:
  1. one representative of the State Police Retirement System
  2. one representative of the Law Enforcement Officers' Pension System.
  3. one representative of the Maryland State Fraternal Order of Police, and
  4. one representative of the Baltimore Retired Police Benevolent Association.

The Department of Legislative Services assigned Mr. Robert Rehrmann to assist the Task Force. Mr. Howard Pleines and Ms. Sherlynn Matesky were assigned by the State Retirement Agency as staff to the Task Force. Ms. Margaret Bury, Retirement System's Administrator, and Ms. Deborah Bacharach, SRA Assistant Attorney General, also participated in the discussions.

The Task Force was charged to study the issue of exempting members of the State Police Retirement System, the Law Enforcement Officers' Pension System, the Local Fire and Police System, any local law enforcement officers system, and State parole and probation officers from paying Maryland income taxes on their pensions. The study charges included:

- identifying the benefit that members of these retirement or pension systems would derive from an exemption;
- determining the potential impact on State revenues and the ongoing structural budget deficit;
- determining the impact on the State Retirement and Pension System; and,
- identifying administrative and legal changes necessary to implement an exemption.

The Task force membership was finalized in early October, with Governor Ehrlich appointing Mr. Thomas K. Lee, Executive Director of the State Retirement Agency, to serve as chairman. The Task Force met at the offices of the State Retirement and Pension System on October 15, November 15, and December 13, 2004.

## BACKGROUND

Law enforcement personnel participate in a variety of State and local pension systems. While many locations, including the State, provide systems or plans that are restricted only to law enforcement and/or public safety personnel, smaller or less-affluent jurisdictions tend to include such individuals in their general employee pension plan. Most public employers provided defined benefit plans, that is, plans that offer death, disability and retirement benefits based on accrued service and/or age. The more generous "police" plans provide not only higher benefits but also permit retirement with less service (20 or 25 years of service) and at a younger age (50 or 55). General employee plans tend to provide for service retirement after 30 years of service and/or at a normal retirement age, likely to be age 60, 62, or 65.

A few municipalities place their law enforcement personnel in defined contribution (DC) plans. Under a DC plan, the employer pays a fixed annual amount into the plan, which is invested in various approved products in accordance with the selections of the participating employees. The employees then bear the performance risks of their decisions, with poor performance producing smaller benefits. It is also noted that defined contribution plans do not offer death and disability benefits, nor recognize the hazardous nature of law enforcement in any way. Generally, the DC plans are offered to law enforcement personnel when such plans are the only pension plan offered by their employer.

The pension income derived from these systems or plans - whether specific to law enforcement or part of a general employee plans, or whether a defined benefit or defined contribution plan - is subject to Maryland's income taxes.

A primary source of information on retired law enforcement personnel available to the Task Force was the 2004 Actuarial Valuation prepared by Milliman USA. The data for State law enforcement personnel involved the State Police Retirement System (SPRS), the Law Enforcement Officers' Pension System (LEOPS) - State employees only, and the Local Fire and Police System (LF&PS). Many of the assumptions that the Task Force was required to make for this report were based on data obtained from these three State law enforcement systems since, in many cases, it was not possible to obtain specific data from local governments, nor segregate information on law enforcement retirees from data on other retirees.

It also is noted that several governmental units only participate in the State System's Employees' Contributory Pension System (ECPS). Most of these employers could not segregate their retired police officers from other retirees. The benefits estimated for these retirees, therefore, are the average benefit provided for their ECPS retirees.

Information on the location of various law enforcement personnel throughout Maryland was obtained through the Maryland Police Training Commission. Retirement Agency staff contacted these various local systems, counties, cities or towns to obtain data related to their retired law enforcement personnel. Staff obtained the number of current retirees and an average pension benefit for each location, when available. Where information related to law enforcement personnel was not available, or no responses were received, staff has assumed that 15% of the active population is retired and that the average pension would equal the benefits paid to retirees of the ECPS. Municipalities listed as having less than 15 active employees are not included in the results from this report.

Based on advice from the Retirement Agency's principal counsel, Ms. Deborah Bacharach, the report also includes information on the impact of exempting the pensions of federal retired law enforcement officers who reside in Maryland from State tax. Case law makes it clear that any extension of a tax exemption by Maryland for its retired law enforcement officers must include retired federal law enforcement personnel who reside in Maryland.

The Office of Personnel Management estimated that there are approximately 83,000 retired federal law enforcement officers. Because of Maryland's proximity to Washington D.C., the Task Force determined it reasonable to assume that 3.5% of that total number now resides in Maryland. The Office of Personnel Management also indicated that the average retired federal law enforcement pension is \$60,000 per year.

Within the total population of the retirees of the State Retirement and Pension System, approximately 19% of those retirees live outside of Maryland and, therefore, are not subject to

Maryland's income tax at this time. Few employers or systems for various reasons could, or would, provide information on the present location of their retired law enforcement officers. Since little information could be obtained about the residences of law enforcement retirees, 19% is the assumption used for this report

It is unclear as to whether law enforcement retirees, who generally retire at a younger age, are more likely to continue residing in Maryland, at least initially, or relocate. Many may remain because of a greater ease in obtaining additional employment. It is also unknown as to the number of those who are retired who lived out-of-state while employed. It can be assumed that retirees do relocate, probably for one of the following reasons.

- Better tax treatments – in the several states surrounding Maryland, most are assumed to have lower taxes. The Retirement Living Information Center ranks states as to their overall tax burden. Delaware offers one of the lowest tax burdens as a percentage of income ranking 48<sup>th</sup>, as compared to Maryland at 24<sup>th</sup>. Pennsylvania (which does not tax pension income) and Virginia also rank better overall than Maryland, coming in at 35<sup>th</sup> and 37<sup>th</sup> respectively.
- More favorable climate - as with many retirees, older citizens migrate south, to Florida and other "warm-weather" states to avoid the harsher winters in the North.

The Task Force notes the existence of a second task force established by the Maryland General Assembly. The Task Force to Study the Dynamics of Elderly Migration Into and Out of the State of Maryland is studying the migration issue at this time. It is likely that this group will report its findings in December 2005.

Based on data from the three State law enforcement systems, it is assumed that 17% of the retirees are disabled (accidental or special disability) and, therefore, exempt from all income tax, both federal and state. The percentages of retirees age 50 to 64 (57%) and 55 to 64 (38%) used in the calculation of costs also are based on the ages of retirees within these systems.

#### **MARYLAND INCOME TAX**

Based on information supplied by the Comptroller's Office, 2.5 million returns were filed in 2003 for payment of Maryland income tax. Of this total, 1.46 million returns included some form of tax exemption. Two impact specifically on pension income:

- Exemption for elderly pensioners, who are 65 and older, and
- Exemption for pensioners, with a total disability or a spouse who is totally disabled.

The maximum tax exemption for 2004 for these two groups is \$20,700. This exemption is based on the maximum annual social security benefit allowable for an individual who is retired at age 65 for the prior calendar year, rounded to the nearest \$100. The annual maximum benefit is reduced by any social security payments received by the retirees.

Maryland's present income tax rate is approximately 4.75%. Counties, and Baltimore City, have the authority to establish a "piggy-back" tax. All have done so, with the local additional tax ranging from a low of 1.25% in Worcester County to a high of 3.20% (Howard, Montgomery and Prince George's Counties). For the purposes of estimating the cost of expanding tax exemptions in this report, an average of 2.82% for the "piggy-back" tax will be used, along with the 4.75% for the State. It is also assumed that for "state" law enforcement retirees who are 65 or older and, therefore, eligible for the State's tax exemption, 50% of their pension is assumed to be exempt.

For federal retirees, the assumed percentage is 40% because of their higher overall pension benefits.

### **RECENT TAX LEGISLATION (Proposals)**

The Task Force notes that, as charged, the results focus on law enforcement personnel as specified in Chapter 543 of 2004. The Task Force did discuss the impact a broadening of current exemptions would have on the efforts of other groups (correctional officers, public safety personnel, military retirees, and teachers, for example) to broaden existing tax exemptions or create new ones for those groups.

Following are examples of legislation proposed but not enacted in 2004 that would have impacted on the taxation of pension income. The legislation would have affected State and local income taxes in various ways.

- HB59 – Altered (increased) the computation of the State’s pension exclusion subtraction modification.
- HB791 – Created a subtraction modification for the first \$5,000 in income resulting from the retirement income of a State elementary or secondary school teacher.
- HB1173 – Permitted rollover from an IRA to be included within the subtraction modification allowed for retirement income from an employee retirement system under certain conditions.
- HB1182 – Expanded existing military subtraction modification to 100% for 20 year military retirees.
- HB1215 – Increased the maximum allowed under the income tax subtraction modification for military retirement income from \$2,500 to \$5,000.
- SB659 – Increased the existing State pension exclusion subtraction modification for joint filers to twice the amount of the maximum annual benefits payable under the Social Security Act, reduced by any Social Security payments received.

### **PROPOSALS FOR CONSIDERATION**

The Task Force recognizes the serious fiscal condition of the State that exists today. The following are the Task Force’s proposals that should receive further consideration in the future when the State’s fiscal outlook has improved. Refer to Appendix D for the potential revenue impact on the State and local governments.

Modifying taxes, in any way, would require amending the current tax code. It must be noted that changes to tax law would not impact the State Retirement and Pension System or the Retirement Agency.

#### **Exempt All Pension:**

- **From retirement**

It is estimated that 6,235 “state” retirees would be impacted by amending tax laws to exempt all pension income from state taxes from the effective date of retirement, regardless of the age at retirement. In addition, 2,411 federal service retirees would have to be included. The total revenue loss for this proposal would be \$21,874,061

- **From age 50:**

It is estimated that 3,030 "state" retirees would be impacted by this proposal, which would exempt pension income from state taxes beginning at age 50 – full pension from age 50 and the current tax percentage of pension from age 65 (assumed at 50% for this report). In addition, 1,624 federal service retirees would be impacted. The total revenue loss for this proposal would be \$14,027,800

- **From age 55:**

It is estimated that 2,214 "state" retirees would be impacted by this proposal, which would exempt pension income from state taxes beginning at age 55. In addition, 1,276 federal service retirees would be impacted. The total revenue loss for this proposal would be \$10,549,467.

**Extend Current Pension Exemption to Include Law Enforcement Pensions:**

- **From retirement**

It is estimated that 4,296 "state" retirees would be impacted by this proposal, which would extend the existing pension exemption currently provided for the elderly and ordinary disability retirees to law enforcement retirees. In addition, 1,830 federal service retirees would be impacted. The total revenue loss for this proposal would be \$12,167,233.

- **From age 50**

It is estimated that 2,449 "state" retirees would be impacted by this proposal, which would extend the existing pension exemption currently provided for the elderly and ordinary disability retirees to law enforcement retirees. In addition, 1,043 federal service retirees would be impacted. The total revenue loss for this proposal would be \$6,941,022.

- **From age 55**

It is estimated that 1,632 "state" retirees would be impacted by this proposal, which would extend the existing pension exemption currently provided for the elderly and ordinary disability retirees to law enforcement retirees. In addition, 695 federal service retirees would be impacted. The total revenue loss for this proposal would be \$4,627,346.

## **IMPACT ON RETIREES**

The State Comptroller's Office indicates that extending the exemption, in any form suggested in this report, should have the same general impact on state and local taxes for retirees in any given tax year. The amount of the income exempted would result in a 7.5% gain for the retiree on that money.

For example, the average final compensation for a new retiree of the State Police Retirement System is \$62,693. Assuming that a trooper started work at age 22 and worked for the minimum 22 years needed to qualify for a service retirement benefit, this trooper would have retired at age 44. The monthly benefit would be approximately \$2,931 per month (\$35,170 annual). If the proposal to exempt full pension from retirement were applied, then beginning at age 44, this retiree saves \$2,638 ( $\$35,170 \times .0750$ ) in state and local tax each tax year. Note that this example does not reflect increases to benefits that would result from future cost-of-living adjustments, nor does it factor in the impact of social security benefits at age 65.

Now assume that with the same benefit noted above, the proposal is less generous and only extends the existing pension exemption to retirement. From age 44, half of the pension, or \$17,553 would be exempt. The tax saving to this trooper would be \$1,316. Again, the savings on the now exempt income is 7.5%.

Similar results would be found for electing to exempt all pension or extending the existing exemption to age 50 or age 55 – 7.5% savings.

Appendix A

**ACTIVE LAW ENFORCEMENT OFFICERS BY COUNTY AND PLAN**

| Maryland Counties | Number of Active Officers                                  | ECPS   | LEOPS | Local Police Plan | Local Employees Plan |
|-------------------|--|--------|-------|-------------------|----------------------|
| Allegany          | Sheriffs 21  | X      |       |                   |                      |
| Anne Arundel      | Police 611<br>Sheriffs 60                                  |        |       | X                 | X                    |
| Baltimore City    | Police 3183<br>Sheriffs 158                                |        | X     | X                 |                      |
| Baltimore County  | Police 1798<br>Sheriffs 66                                 |        |       | X<br>X            |                      |
| Calvert           | Sheriffs 86  |        |       |                   | X                    |
| Caroline          | Sheriffs 23  |        |       |                   | X                    |
| Carroll           | Sheriffs 57  |        |       |                   | X                    |
| Cecil             | Sheriffs 64  |        |       | X                 |                      |
| Charles           | Sheriffs 249   |        |       | X                 |                      |
| Dorchester        | Sheriffs 31  | X      |       |                   |                      |
| Frederick         | Sheriff 158  |        |       |                   | X                    |
| Garrett           | Sheriffs 23  |        |       | X                 |                      |
| Harford           | Sheriffs 241   |        |       | X                 |                      |
| Howard            | Police 347<br>Sheriffs 37                                  |        |       | X                 | X                    |
| Kent              | Sheriffs 20  |        | X     |                   |                      |
| Montgomery        | Police 1109<br>Sheriff 133                                 |        |       | X                 | X                    |
| Prince Georges    | Police 1255<br>Schools 57<br>Sheriffs 173<br>PG College 14 | X<br>X |       | X                 | X<br>X               |
| Queen Anne's      | Sheriffs 45  |        | X     |                   |                      |
| St. Mary's        | Sheriffs 106   | X      |       |                   |                      |
| Somerset          | Sheriffs 20  | X      |       |                   |                      |
| Talbot            | Sheriffs 21  | X      |       |                   |                      |
| Washington        | Sheriffs 75  |        |       |                   | X                    |
| Wicomico          | Sheriffs 104   |        |       |                   | X                    |
| Worcester         | Worcester 53   | X      |       |                   |                      |

**SRPS** State Retirement and Pension System  
**ECPS** Employees' Contributory Pension System (State System)  
**LEOPS** Law Enforcement Officers' Pension Plan (State System)  
**LFPS** Local Fire and Police System (State System closed to new municipalities as of January 1, 2005)

**NOTES:**  
 Eight municipalities participate in LEOPS (258 officers): Kent County, Queen Anne's County, Cambridge, Greenbelt, Hancock, Hyattsville, Salisbury and Westminster.  
 Two municipalities that participate in LFPS (55 officers): Cumberland and Hurlock (LFPS is a closed system- no new employers as of December 31, 2004)

Appendix B

**RETIRED LAW ENFORCEMENT OFFICERS BY STATE SYSTEM AND COUNTY**

| System                                   | Number of Retirees            | Average Monthly Pension | Comments                      |
|--|-------------------------------|-------------------------|-------------------------------|
| SPRS                                     | 1790                          | \$2,900                 |                               |
| LEOPS                                    | 581                           | \$2,175                 |                               |
| LFPS                                     | 37                            | \$1,567                 |                               |
| ECPS                                     | 7*                            | \$1,171**               | Parole Officers               |
| Allegany                                 | 3*                            | \$1,171**               |                               |
| Anne Arundel                             | 408 (police<br>12 (sheriffs)  | \$2,789<br>\$1,840      |                               |
| Baltimore City (includes firefighters)   | 5430                          | \$2,308                 | 3258 (60%)<br>Police Officers |
| Baltimore County                         | 1283                          | \$2,666                 |                               |
| Calvert                                  | 11                            | \$1,911                 |                               |
| Caroline                                 | 4                             | \$1,266                 |                               |
| Carroll                                  | 9*                            | \$1,000                 |                               |
| Cecil                                    | 17                            | \$1,190                 |                               |
| Charles                                  | 92                            | \$2,798                 |                               |
| Dorchester                               | 5*                            | \$1,171**               |                               |
| Frederick                                | 39                            | \$1,682                 |                               |
| Garrett                                  | 2                             | \$1,800                 |                               |
| Harford                                  | 36*                           | \$3,125                 |                               |
| Howard                                   | 100 (police)<br>10 (sheriffs) | \$2,984<br>1,171**      |                               |
| Kent                                     | 3*                            | \$1,900***              | LEOPS                         |
| Montgomery County                        | 750                           | \$2,666                 |                               |
| Prince Georges County                    | 963                           | \$3,000                 |                               |
| Queen Anne's                             | 7*                            | \$1,900***              | LEOPS                         |
| St. Mary's                               | 16*                           | \$1,171**               |                               |
| Somerset                                 | 3*                            | \$1,171**               |                               |
| Talbot                                   | 3*                            | \$1,171**               |                               |
| Washington                               | 11*                           | \$2,291                 |                               |
| Wicomico                                 | 16*                           | \$2,208                 |                               |
| Worcester                                | 8*                            | \$1,171**               |                               |
| MD Capitol Parks and Planning Commission | 93 ****                       | \$3,475                 |                               |
| Total                                    | 9,577                         |                         |                               |

Notes:

- \* Estimated at 15% of current officers
- \*\* \$1,171 based on average final salary of \$38,000 - 25 years at 1.2 and 5 years at 1.4
- \*\*\* \$1,900 based on LEOP benefit - 60% of average final salary of \$38,000
- \*\*\*\* Commission covers more than one county

**Plans within the State Retirement and Pension System**

- SPRS – State Police Retirement System
- LEOPS-Law Enforcement Pension System
- LFPS – Local Fire and Police System
- ECPS – Parole and Probation Police Officers

**RETIRED LAW ENFORCEMENT OFFICERS BY CITIES AND TOWNS**

| City or Town   | Number of Retirees | Average Monthly Pension | Comments                     |
|----------------|--------------------|-------------------------|------------------------------|
| Aberdeen       | 3                  | \$500                   | Old Plan                     |
| Annapolis      | 92                 | \$2,219                 | Police Plan                  |
| Bel Air        | 1                  | \$1,712                 | Police Plan                  |
| Easton         | 6*                 | \$1171**                |                              |
| Elkton         | 4*                 | \$1,000                 | DC Plan                      |
| Frederick      | 50                 | \$2,000                 | Police Plan                  |
| Frostburg      | 4                  | \$1,000                 | EE /DC Plan                  |
| Gaithersburg   | 6*                 | \$1,171**               |                              |
| Havre-de-Grace | 0(3)               | \$1,171                 | Police Plan                  |
| Laurel         | 6*                 | \$1,171**               |                              |
| Ocean City     | 15                 | \$2,408                 | Public Safety Plan           |
| Riverdale Park | 1                  | \$2,125                 | DB Plan/DC Plan<br>elect one |
| Rockville      | 6*                 | \$2,666***              | Police Plan                  |
| Takoma Park    | 5*                 | \$2,666***              | Police Plan                  |
| LEOPS          | 19****             | \$1,900*****            |                              |
| Total          | 218                |                         |                              |

DC- Defined Contribution Plan

EE -General Employee Plan

DB - Defined Benefit Plan

LEOPS - Law Enforcement Officers Pension System

**Notes:**

\* Estimated at 15% of current officers

\*\* \$1,171 based on average final salary of \$38,000 - 25 years 1.2% and 5 years 1.4%

\*\*\* Average for Montgomery County police officers

\*\*\*\* Salisbury, Greenbelt, Cambridge, Westminster participate in LEOPS

\*\*\*\*\* \$1,900 based on LEOP benefit - 60% of average final salary of \$38,000

## Appendix D

| <b>Potential Revenue Impact</b> |                  |                  |                  |                  |                           |
|---------------------------------|------------------|------------------|------------------|------------------|---------------------------|
| <b>Exempt All Pension</b>       | <b>State Tax</b> |                  | <b>Local Tax</b> |                  | <b>Total Lost Revenue</b> |
|                                 | State Retirees   | Federal Retirees | State Retirees   | Federal Retirees |                           |
| From Retirement                 | \$7,730,747      | \$6,043,425      | \$4,512,003      | \$3,587,886      | \$21,874,061              |
| From Age 50                     | \$5,019,998      | \$3,800,760      | \$2,950,591      | \$2,256,451      | \$14,027,800              |
| From Age 55                     | \$3,822,225      | \$2,809,815      | \$2,249,285      | \$1,668,142      | \$10,549,467              |

| <b>Extend Pension Exemption</b> | <b>State Tax</b> |                  | <b>Local Tax</b> |                  | <b>Total Lost Revenue</b> |
|---------------------------------|------------------|------------------|------------------|------------------|---------------------------|
|                                 | State Retirees   | Federal Retirees | State Retirees   | Federal Retirees |                           |
| From Retirement                 | \$3,152,034      | \$5,215,500      | \$713,339        | \$3,096,360      | \$12,167,233              |
| From Age 50                     | \$1,796,659      | \$2,972,835      | \$406,603        | \$1,764,925      | \$6,941,022               |
| From Age 55                     | \$1,197,772      | \$1,981,890      | \$271,068        | \$1,176,616      | \$4,627,346               |

**Maryland State and Local Tax Revenues  
Comparison to Selected States  
Fiscal 2002 Tax Revenues Per Capita**

|                         | Property<br>Tax | Personal<br>Income<br>Tax | Corporate<br>Income<br>Tax | Sales &<br>Selective<br>Taxes <sup>(1)</sup> | License<br>Fees | Other<br>Taxes <sup>(2)</sup> | All<br>Taxes   |
|-------------------------|-----------------|---------------------------|----------------------------|--|-----------------|-------------------------------|----------------|
| District of<br>Columbia |                 |                           |                            |  |                 |                               |                |
| Amount                  | \$1,412         | \$1,668                   | \$371                      | \$1,644                                      | \$88            | \$489                         | \$5,671        |
| Rank                    | 5               | 1                         | 2                          | 4  | 40              | 3                             | 1              |
| New Jersey              |                 |                           |                            |  |                 |                               |                |
| Amount                  | \$1,872         | \$801                     | \$128                      | \$1,027                                      | \$112           | \$99                          | \$4,038        |
| Rank                    | 1               | 17                        | 8                          | 31   | 29              | 25                            | 4              |
| <b>Maryland</b>         |                 |                           |                            |  |                 |                               |                |
| <b>Amount</b>           | <b>\$993</b>    | <b>\$1,402</b>            | <b>\$66</b>                | <b>\$913</b>                                 | <b>\$80</b>     | <b>\$192</b>                  | <b>\$3,646</b> |
| <b>Rank</b>             | <b>17</b>       | <b>3</b>                  | <b>27</b>                  | <b>41</b>                                    | <b>44</b>       | <b>10</b>                     | <b>7</b>       |
| Virginia                |                 |                           |                            |  |                 |                               |                |
| Amount                  | \$921           | \$921                     | \$42                       | \$898  | \$93            | \$162                         | \$3,037        |
| Rank                    | 27              | 11                        | 44                         | 42   | 39              | 15                            | 24             |
| Delaware                |                 |                           |                            |  |                 |                               |                |
| Amount                  | \$496           | \$947                     | \$312                      | \$405  | \$968           | \$205                         | \$3,334        |
| Rank                    | 44              | 9                         | 3                          | 50   | 1               | 8                             | 14             |
| Pennsylvania            |                 |                           |                            |  |                 |                               |                |
| Amount                  | \$885           | \$771                     | \$97                       | \$916  | \$169           | \$214                         | \$3,052        |
| Rank                    | 29              | 19                        | 14                         | 40   | 11              | 6                             | 22             |
| North Carolina          |                 |                           |                            |  |                 |                               |                |
| Amount                  | \$653           | \$875                     | \$80                       | \$945  | \$110           | \$55                          | \$2,718        |
| Rank                    | 39              | 14                        | 17                         | 37   | 30              | 40                            | 33             |
| West Virginia           |                 |                           |                            |  |                 |                               |                |
| Amount                  | \$499           | \$573                     | \$122                      | \$1,097                                      | \$97            | \$183                         | \$2,572        |
| Rank                    | 43              | 34                        | 10                         | 24   | 34              | 11                            | 41             |
| <b>U.S. Average</b>     | <b>\$969</b>    | <b>\$704</b>              | <b>\$98</b>                | <b>\$1,125</b>                               | <b>\$128</b>    | <b>\$118</b>                  | <b>\$3,143</b> |

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n.a.," the State does not have that tax.

<sup>(1)</sup>Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and other taxes.

<sup>(2)</sup>Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Source: 2002 Census of Government, U.S. Bureau of the Census (July 2004)

**Maryland State and Local Tax Revenues  
Comparison to Selected States  
Fiscal 2002 Tax Revenues as a Percentage of Personal Income**

|                         | Property<br>Tax | Personal<br>Income<br>Tax | Corporate<br>Income<br>Tax | Sales &<br>Selective<br>Taxes <sup>(1)</sup> | License<br>Fees | Other<br>Taxes <sup>(2)</sup> | All<br>Taxes |
|-------------------------|-----------------|---------------------------|----------------------------|--|-----------------|-------------------------------|--------------|
| District of<br>Columbia | 3.0%            | 3.6%                      | 0.8%                       | 3.5%   | 0.2%            | 1.0%                          | 12.1%        |
| Rank                    | 26              | 4                         | 4                          | 27   | 50              | 4                             | 3            |
| New Jersey              | 4.7%            | 2.0%                      | 0.3%                       | 2.6%   | 0.3%            | 0.3%                          | 10.2%        |
| Rank                    | 3               | 36                        | 11                         | 44   | 40              | 33                            | 21           |
| <b>Maryland</b>         | <b>2.7%</b>     | <b>3.9%</b>               | <b>0.2%</b>                | <b>2.5%</b>                                  | <b>0.2%</b>     | <b>0.5%</b>                   | <b>10.0%</b> |
| Rank                    | <b>34</b>       | <b>2</b>                  | <b>39</b>                  | <b>45</b>                                    | <b>44</b>       | <b>17</b>                     | <b>28</b>    |
| Virginia                | 2.8%            | 2.8%                      | 0.1%                       | 2.7%   | 0.3%            | 0.5%                          | 9.3%         |
| Rank                    | 31              | 16                        | 44                         | 43   | 39              | 19                            | 44           |
| Delaware                | 1.6%            | 3.0%                      | 1.0%                       | 1.3%   | 3.0%            | 0.6%                          | 10.4%        |
| Rank                    | 50              | 13                        | 2                          | 50   | 1               | 10                            | 17           |
| Pennsylvania            | 2.8%            | 2.5%                      | 0.3%                       | 2.9%   | 0.5%            | 0.7%                          | 9.8%         |
| Rank                    | 30              | 21                        | 15                         | 42   | 12              | 7                             | 33           |
| North Carolina          | 2.4%            | 3.2%                      | 0.3%                       | 3.4%   | 0.4%            | 0.2%                          | 9.8%         |
| Rank                    | 41              | 9                         | 20                         | 33   | 31              | 41                            | 34           |
| West Virginia           | 2.1%            | 2.4%                      | 0.5%                       | 4.6%   | 0.28            | 0.8%                          | 10.8%        |
| Rank                    | 43              | 25                        | 7                          | 11   | 24              | 6                             | 10           |
| <b>U.S. Average</b>     | <b>3.1%</b>     | <b>2.3%</b>               | <b>0.3%</b>                | <b>3.6%</b>                                  | <b>0.4%</b>     | <b>0.4%</b>                   | <b>10.2%</b> |

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n.a.," the State does not have that tax.

<sup>(1)</sup>Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and other taxes.

<sup>(2)</sup>Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Source: 2002 Census of Government, U.S. Bureau of the Census (July 2004)

**ASSUMPTIONS**

- **19% of retirees reside out of state**
- **17% of retirees receive total disability (tax free)**
- **20% of retiree are 65 or older**
- **50 % of pension is taxable if 65 or older**
- **15% of active law enforcement officers are retired and receive ECPS benefit (for municipalities when data was not available)**
- **If combined police/firefighter system – used 60/40 split**
- **3.5% of federal retirees reside in Maryland**
- **The average federal pension for retired law enforcement is \$60,000 per year.**
- **57% or retirees are age 50-55; 38% are age 55-64**
- **4.75% - assumed State tax rate**
- **2.82% - assumed local tax rate**

OFFICE OF THE ATTORNEY GENERAL  
MARYLAND STATE RETIREMENT AND PENSION SYSTEM  
120 E. Baltimore Street  
Baltimore, MD 21202  
Telephone: (410) 625-5671  
Facsimile: (410) 468-1705

November 5, 2004

**MEMORANDUM**

**TO:** Thomas K. Lee, Executive Director

**FROM:** Deborah Bacharach, Principal Counsel

**RE:** Tax Issue: Exemption of Law Enforcement Officers' Pensions from State Taxation

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You have been designated the Chairman of the Task Force on the Exemption of Law Enforcement Officers' Pensions from Taxation. The Task Force is a creature of H.B. 1125 enacted by the 2004 General Assembly. The Task Force has begun to meet, is compiling information, and is required to report its findings to the Governor and the General Assembly on or before December 31, 2004. In accordance with H.B. 1125, the Task Force has been directed to:

“study the issue of exempting members of the State Police Retirement System, the Law Enforcement Officers' Pension System, the Local Fire and Police System, any local pension or retirement system for law enforcement officers, and parole and probation officers who are members of the Employees' Retirement System or the Employees' Pension System from paying State income taxes on their pensions. . .”

In particular, the Task Force is directed to study the “administrative and legal changes necessary to implement such an exemption.” In light of those provisions, you have asked me whether I am aware of any legal restrictions that would apply to a legislative proposal designed to exempt the pensions of these state law enforcement officers from State income tax.

I am aware of a critical limitation on the State's power to exempt the pension income of certain state law enforcement officers. In accordance with a Supreme Court case decided in 1989, *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), the State is not permitted to exempt the pension income of retired state law enforcement officers without also exempting the pension income of any retired federal law enforcement officers from State income tax.

### **The Davis Case**

Under Michigan's income tax law, retirement benefits received by former state and local government employees were tax-exempt; retirement benefits received by former federal employees, as well as by private sector employees, were not. Davis, a retired federal employee, sued for a refund for the tax that he had paid on his retirement benefits, claiming that a tax break afforded to state but not federal retirees was impermissible under federal law. The Supreme Court agreed. *Davis v. Michigan, Id.* "[T]he dispositive question in this case," the Court wrote, is whether the tax imposed on [Davis] is barred by the doctrine of intergovernmental tax immunity." 489 U.S. at 814. This doctrine originated in Chief Justice Marshall's opinion in *McCulloch v. Maryland*, 4 Wheat.316 (1819), in which the Supreme Court invalidated a discriminatory tax imposed by Maryland on the Bank of the United States. As it has evolved, the doctrine prohibits "those taxes that were imposed directly on one sovereign by the other **or that discriminated against a sovereign or those with whom it dealt....**" (Emphasis added). 489 U.S. at 811.

The Supreme Court found that the Michigan scheme "discriminates in favor of retired state employees and against retired federal employees." 492 U.S. at 814. Such discrimination could be justified constitutionally only if "the inconsistent tax treatment is directly related to and justified by 'significant differences between the two classes.' Michigan's asserted justifications--that the tax exemption served the state's interest in hiring and retaining qualified civil servants, and that state retirement benefits were less generous overall than federal retirement benefits--were rejected by the Court. It concluded that "the Michigan Income Tax Act violates principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees." 489 U.S. at 817. *See also*, 74 Md. Op. Atty. Gen. 275 (1989).

### **Conclusion**

Based upon the Supreme Court's decision in this case, it is clear that any legislation proposed to exempt the pension income of state law enforcement officers must also exempt the pension income of federal law enforcement officers.  
Please let me know if you have any questions regarding this matter.

Cc: Howard Pleines